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PAGE 01 OECD P 05961 01 OF 02 272201Z

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ACTION EUR-12

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TO SECSTATE WASH DC 0854

INFO AMEMBASSY STOCKHOLM

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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)

REVIEW OF SWEDEN, MARCH 8, 1976

REF: EDR(76)5

L. SUMMARY. IN REFDOC CIRCULATED FOR MARCH 8 EDRC
REVIEW OF SWEDEN, SECRETARIAT EMPHASIZES THAT SWEDEN
WAS ONE OF FEW OECD MEMBER COUNTRIES THAT DID NOT
EXPERIENCE FALL IN OUTPUT AND EMPLOYMENT IN 1975; REAL
GDP GREW BY 0.5 PERCENT AND UNEMPLOYMENT REACHED LOWEST
LEVEL IN FIVE YEARS. SECRETARIAT ATTRIBUTES SWEDISH
PERFORMANCE LARGEMLY TO TIMELY IMPLEMENTATION OF EMPLOY-
MENT MAINTENANCE (INVENTORY ACCUMULATION SUBSIDIES) AND
INVESTMENT STIMULATION SCHEMES. SECRETARIAT SEES MAJOR
PROBLEM AS RAPID WAGE AND PRICE INCREASES WHICH COULD
LEAD TO CONTINUED DETERIORATION IN SWEDISH COMPETITIVE
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PAGE 02 OECD P 05961 01 OF 02 272201Z

POSITION, WITH NEGATIVE FEEDBACK ONTO LABOR MARKET. IN

ADDITION, LARGE CURRENT ACCOUNT DEFICITS IN 1975 (1.5 BILLION) AND PROJECTED FOR 1976 (\$1 BILLION) COULD LEAD TO FINANCING PROBLEMS OVER MEDIUM TERM, AND SECRETARIAT SUPPORTS SWEDISH OBJECTIVE TO RESTORE CURRENT ACCOUNT BALANCE BY 1980. BECAUSE OF DANGER OF ACCELERATED INFLATION AND CURRENT ACCOUNT DETERIORATION, SECRETARIAT FEELS THAT GROWTH IN 1976 SHOULD BE EXPORT LED, RECOMMENDS "WAIT AND SEE" DEMAND MANAGEMENT POLICY FOR 1976 AND URGES THAT GOVERNMENT ATTEMPT TO DEVELOP CONSENSUS THAT SCOPE FOR REAL WAGE INCREASES IS LIMITED AND THAT IT WOULD BE DESIRABLE TO ACHIEVE GIVEN INCREASES IN REAL WAGES AT LOWER RATHER THAN HIGHER NOMINAL INCREASES. ACTION REQUESTED: MISSION WOULD APPRECIATE COMMENTS/QUESTIONS THAT COULD USEFULLY BE POSED AT EDRC REVIEW. FOR STOCKHOLM: MISSION WOULD WELCOME EMBASSY COMMENTS ON SECRETARIAT'S EVALUATION OF SWEDISH POLICY IN 1975 AND RECOMMENDATIONS FOR 1976, AS WELL AS PARTICIPATION IN EDRC REVIEW BY EMBASSY REPRESENTATIVE.

2. SHORT-RUN OUTLOOK; DOMESTIC PROSPECTS: FOR 1975, SECRETARIAT UNDERLINES SWEDISH SUCCESS IN MAINTAINING GROWTH IN REAL OUTPUT (0.5 PERCENT) AND EMPLOYMENT DESPITE LARGE DROP IN EXPORT VOLUMES (NEGATIVE IMPACT OF EXTERNAL SECTOR WAS 3 PERCENT IN 1975), AND POINTS TO INVENTORY SUBSIDY SCHEME AND OPERATIONS OF INVESTMENT STIMULATION SCHEMES AS IMPORTANT FACTORS SUPPORTING ACTIVITY. SECRETARIAT BELIEVES THAT SUBSIDIES FOR STOCKBUILDING WERE USEFULLY CONDITIONED UPON FIRM'S MAINTAINING EMPLOYMENT LEVELS. ACCESS OF FIRMS TO STOCKBUILDING SUBSIDIES AS WELL AS TO INVESTMENT FUNDS (INTO WHICH FIRMS PAID UP TO 35 PERCENT OF THEIR 1974 PROFITS) EASED FINANCING OF BOTH NEW INVESTMENT AND OF STOCKS. STOCK ACCUMULATION AND INVESTMENT SCHEMES WERE ALSO COMPLEMENTED BY STIMULATORY FISCAL AND MONETARY POLICIES, AND OVERALL POLICY TASK OF MAINTAINING EMPLOYMENT WAS EASED BY FACT THAT CAPITAL INTENSIVE INDUSTRIES SUFFERED STRONGEST DECLINES IN OUTPUT. FOR 1976 SECRETARIAT PROJECTS DECLINE IN PRIVATE INVESTMENT, (BUT OFFSET BY INCREASE IN PUBLIC INVESTMENT), 2-2.5 PERCENT NEGATIVE CONTRIBUTION OF STOCK MOVEMENTS TO GDP, LIMITED OFFICIAL USE

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PAGE 03 OECD P 05961 01 OF 02 272201Z

2-2.5 PERCENT INCREASE IN PRIVATE CONSUMPTION, 1-1.5 PERCENT INCREASE IN REAL GDP AND SOME DETERIORATION IN LABOR MARKET.

3. SECRETARIAT LESS IMPRESSED BY EVOLUTION OF NOMINAL ECONOMIC MAGNITUDES IN 1975, NOTING THAT WAGE INCREASES OF ABOUT 17 PERCENT DURING THE YEAR ACCOUNTED FOR HALF OF THE 10 PERCENT INCREASE IN CONSUMER PRICES. WAGE

INCREASES OF OVER 15 PERCENT ARE FORECAST FOR 1976 WHICH, COMBINED WITH ONLY A SMALL INCREASE IN PRODUCTIVITY, WILL EXERT UPWARD PRESSURE ON UNIT LABOR COSTS AND ON PRICES. SECRETARIAT ADDS THAT ITS PROJECTION OF 10 PERCENT INCREASE IN CONSUMER PRICES IN 1976 MAY BE LOW, SINCE IT PRESUMES THAT FIRMS WILL REDUCE THEIR PROFIT MARGINS. SECRETARIAT STRESSES ADVERSE EFFECT ON SWEDISH COMPETITIVE POSITION WHICH EXCESSIVE WAGE INCREASES WOULD ENTRAIN, AND RECOMMENDS THAT GOVERNMENT

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PAGE 01 OECD P 05961 02 OF 02 272210Z

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ATTEMPT TO DEVELOP CONSENSUS ON LIMITED SCOPE FOR REAL WAGE INCREASES IN 1976 AND ON DESIRABILITY OF ACHIEVING GIVEN INCREASES IN REAL WAGES WITH SMALLER RATHER THAN LARGER INCREASES IN NOMINAL WAGES. SECRETARIAT ALSO SUGGESTS THAT TAX CONCESSIONS MIGHT BE USED TO SWEETEN POT FOR LABOR BY AUGMENTING REAL INCOME WITHOUT INCREASING NOMINAL WAGES.

4. CURRENT ACCOUNT: RECESSION, PLUS UNFAVORABLE
GEOGRAPHIC AND PRODUCT COMPOSITION OF SWEDISH EXPORTS,
LED TO 9.4 PERCENT DROP IN 1975 VOLUME OF SWEDISH EXPORTS
OF GOODS AND SERVICES WHILE RELATIVELY HIGH LEVEL OF
DOMESTIC DEMAND HELD FALL IN IMPORT VOLUMES TO 2 PERCENT.
AS A RESULT, 1975 CURRENT ACCOUNT DEFICIT REACHED \$1.5
BILLION. FOR 1976, SECRETARIAT PROJECTS 3.5-6.5 INCREASE
IN EXPORT VOLUMES, 0.5-1.0 PERCENT DECLINE IN IMPORT
VOLUMES, AND NO CHANGE IN TERMS OF TRADE. HOWEVER,
SECRETARIAT FEELS THAT IMPROVEMENT IN TRADE BALANCE WILL
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PAGE 02 OECD P 05961 02 OF 02 272210Z

BE INSUFFICIENT TO OFFSET DEFICIT IN SERVICES AND CURRENT
ACCOUNT DEFICIT COULD BE OVER \$1 BILLION. WHILE EXPECT-
ING NO FINANCING PROBLEMS FOR 1976, SECRETARIAT NOTES
THAT CUMULATIVE EXTERNAL DEFICIT IS MOUNTING, AND THAT
RESTORATION OF BALANCE SHOULD BE (AS IT IS) AN IMPORTANT
AIM OF GOVERNMENT POLICY.

5. FISCAL AND MONETARY POLICY: FISCAL AND MONETARY
POLICIES WERE BOTH EXPANSIONARY IN 1975. BUDGETARY
POLICY, WHICH RESULTED IN DEFICIT OF 4 PERCENT OF 1975
GNP, WAS SUCCESSFUL, THROUGH BOTH GENERAL AND SPECIFIC
MEASURES, IN MAINTAINING EMPLOYMENT, AND DEFICIT WAS
FINANCED SO AS TO AVOID EXCESSIVE MONETIZATION OF DEBT
OR "CROWDING OUT" IN FINANCIAL MARKETS. MONETARY POLICY
WAS DESIGNED TO HELP STRIKE BALANCE BETWEEN MONETIZATION/
CROWDING OUT IN FINANCING OF BUDGETARY DEFICIT AND, IN
ADDITION, WAS AIMED AT ENCOURAGING FOREIGN BORROWING TO
FINANCE EXTERNAL DEFICIT AND AT STIMULATING FLOW OF CREDIT
TO BUSINESS. IN VIEW OF DANGER OF ACCELERATED
INFLATION AND CURRENT ACCOUNT DETERIORATION IN 1976,
SECRETARIAT RECOMMENDS "WAIT AND SEE" STANCE FOR DEMAND
MANAGEMENT POLICY, AND FEELS THAT SWEDISH AUTHORITIES
SHOULD ALLOW GROWTH IN WORLD TRADE AND HENCE IN SWEDISH
EXPORTS TO DETERMINE PACE OF RECOVERY.

6. COMMENT: (1) SECRETARIAT COMMENTS IN REFDOC THAT
SWEDISH EXPORTS MAY ACCELERATE IN 1976, BUT THAT EXPORT
PRICES WILL SHOW MARKED DECELERATION; THIS APPEARS
INCONSISTENT WITH SECRETARIAT VIEW THAT SWEDISH TERMS
OF TRADE WOULD NOT CHANGE. MISSION PLANS TO QUESTION
SECRETARIAT ON THIS POINT AND TO QUESTION SWEDISH DEL
ON IMPLICATIONS OF POSSIBLE TERMS OF TRADE DETERIORATION
FOR CURRENT ACCOUNT DEFICIT AND ITS FINANCING IN 1976;
(2) SOCIAL SECURITY TAXES ON BUSINESS ADDED 4 PERCENT TO
LABOR COSTS IN 1975 AND ARE EXPECTED BY SECRETARIAT TO
ADD 3.5 PERCENT IN 1976. MISSION WOULD WISH TO EXPLORE
WITH SWEDISH DEL POSSIBILITY OF REDUCING SOCIAL SECURITY

TAX BURDEN ON FIRMS; (3) SECRETARIAT POINTS TO SUCCESS
OF STOCK SUBSIDY SCHEMES IN MAINTAINING EMPLOYMENT IN
1976. MISSION PLANS TO ASK SWedes TO WHAT EXTENT
EXISTENCE OF LARGE STOCKS MIGHT CONTRIBUTE TO LABOR 1976
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PAGE 03 OECD P 05961 02 OF 02 272210Z

MARKET DETERIORATION EXPECTED BY SECRETARIAT.
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